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Business and Economic Conditions

New York, May, 1959

General Business Conditions

THE business upturn — sharp at first and then more gradual — has been under way for a full year and recovery is now an accomplished fact. Latest reports indicate that many old peaks are being surpassed. Most of the over-all measures of business activity such as industrial production, gross national product, personal income, retail sales, and construction have set new records during recent months. Support for further expansion is provided by a rising backlog of unfilled orders among manufacturers, a disposition of consumers to spend more freely, and a rapid recovery in profits leading to upward revisions in business capital spending plans.

The accelerated inflow of new business, while influenced by hedge-buying in steel, also reflects gathering momentum in other lines. In March, the industrial production index of the Federal Reserve Board (seasonally adjusted, 1947-49 = 100) broke through to a new high of 147, compared with the revised February figure of 145 and the pre-recession peak of 146. Sharply higher rates of steel and auto production were the major factors but increased activity was reported in producers' durable goods and construction materials generally.

Some let-up is to be expected at mid-year, whether or not there is a steel strike. Steel consumption normally dips during the summer and by June 30 many steel users presumably will be stocked up against the contingency of a strike. Opinion is nonetheless optimistic that the fall will find business expanding to new heights.

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Employment and Unemployment

The employment figures, so much a cause of concern during the winter, are showing marked improvement. Civilian employment (which excludes 2.6 million members of the armed forces) advanced vigorously in March, rising 1.1 million from February to 63.8 million. This was up 1½ million from March 1958, and very near to the March 1957 level. Nonfarm employment was the highest for any March on record. Although ordinarily there is little change at this time of year, factory employment increased 150,000, mostly in durable goods industries, to a total of 16.0 million. In manufacturing the average work week, down to 38.3 hours in April 1958, had pushed slightly beyond 40 hours by March of this year; the average paycheck in this period has risen practically 10 per cent.

Unemployment from February to March dropped by nearly 400,000 persons to 4.4 million. The greatest concentrations of unemployment are to be found among older persons and in durable goods manufacturing. Secretary of Labor James P. Mitchell has predicted that by the final quarter of 1959 unemployment will be down to 3 million and that employment will reach "probably the highest level we've ever enjoyed."

Actually, the problem of unemployment is less than it might at first appear. A figure of 3 million

or less indicates a condition of business boom and of labor shortage in some areas and occupations. There are always many persons just entering or leaving the labor force, changing jobs, choosy about what they do, or not adapted for steady work. Unemployment seems not so much a national problem as a series of localized problems, arising out of changing patterns of public and private spending and the fact that the labor force does not seem to be so mobile as it used to be.

Capital Spending

With the snapback of profits and improving business prospects, it is natural that businessmen should dust off plans on the shelf to improve and expand productive facilities. Actions to enlarge capital spending are votes of confidence in the economic outlook. They point the way to broadened employment opportunities.

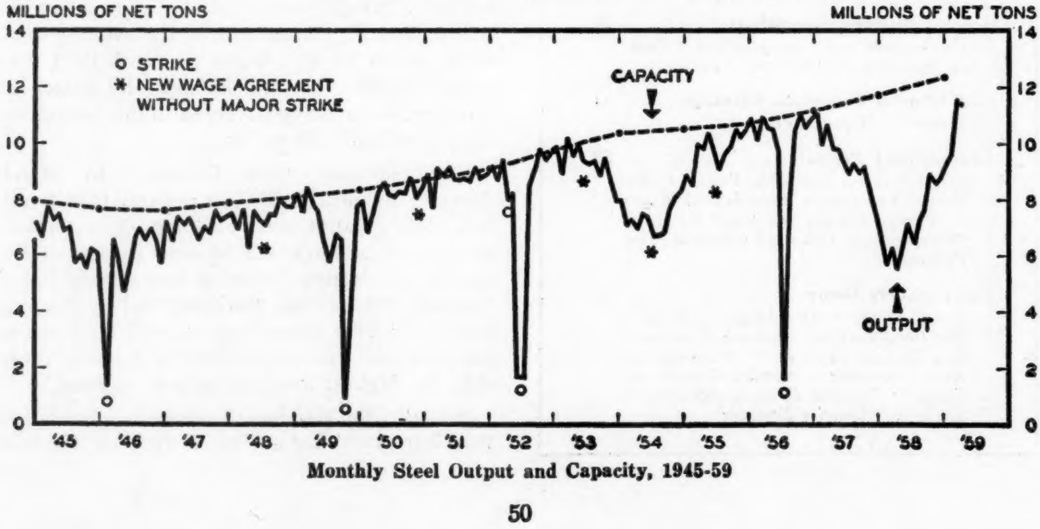
A survey by McGraw-Hill, taken in March, indicates that business will spend $2.1 billion (7 per cent) more on new plant and equipment this year than was spent in 1958. Businessmen have raised their sights since last October when a similar survey reported that they anticipated virtually no increase in capital spending in 1959. If the trend during past business upswings can be taken as typical, it is likely that actual expenditures in 1959 will show still further increases over present plans.

The bulk of capital spending in manufacturing industries during 1959 will be directed toward replacement and modernization rather than toward expansion of capacity. Even with recovery well advanced, manufacturers reported that they were operating at only 80 per cent of capacity at the end of 1958. Emphasis naturally falls on new equipment and techniques which will raise efficiency, cut costs, or improve quality. Not to be overlooked is the stepped-up pace of research and development expenditures, which were increased even during the recession. Industry is expected to spend more than $9 billion on research in 1959 as against $8.2 billion in 1958 and less than $5 billion in 1955. Further increases in research and development expenditures are planned as far ahead as 1962. Out of these expenditures can come new products, new processes, even new industries – the vital ingredients for progress.

A great deal of thought is being given these days to strengthening the growth curve of the economy. Out of natural increases in population come both increased wants and increased potential manpower. To make manpower effective in fulfilling wants will require tens of billions of capital investment in industry.

Increasing depreciation allowances are helpful in providing a foundation for renewal of plant and equipment. But they can never be enough because equipment is becoming more complicated and expensive. Increasing profits can be of further aid though their value is handicapped by the fact that taxation takes the greater part. A more direct encouragement could be provided by liberalization of depreciation allowances. Nearly half the firms in the McGraw-Hill survey stated they would raise expenditures if allowances were liberalized.

A lesson might be drawn from the British book. Wishing to bring its industrial plant up to date, and to meet the problem of higher replacement costs, Great Britain is providing so-called "investment allowances." These afford



Monthly Steel Output and Capacity, 1945-59

permanent remission of taxation on a given percentage of cost of certain types of investment; and, even though these allowances cannot be counted on as a permanent part of the tax structure, they will stimulate investment at a time when industrial capacity is under-employed.

The Steel Situation

Of most immediate concern in the business picture is the expiration of the steel wage contract on June 30. Negotiations are scheduled to begin May 5.

In contrast to the drastic liquidation which took place during most of 1958, steel inventories this year have been increasing – partly because they had become uncomfortably low, partly because of improving sales volume, and partly because of the threat of a strike. The order books of steel producers are virtually full, deliveries are being delayed in many items, and operations at better than 90 per cent of capacity are expected to continue well into June.

This heavy demand pushed ingot production to a record daily rate in April. Because of fewer working days, total output for the month was slightly below the March peak, as shown in the chart on the previous page. In late April mills were operating at about 94 per cent of capacity, equivalent to nearly 140 million tons a year.

Preliminary to this month's steel talks an open exchange of letters took place between twelve of the major steel companies and David J. McDonald, president of the United Steelworkers of America. The steel companies proposed that the union immediately join with them in agreeing "to continue present wages and other benefits, without change, for an additional period of one year beyond June 30, 1959." Mr. McDonald countered with proposals "that there be no increase in the price of steel during the term of any agreement which we may reach" and that increases in wages be granted on the basis of the industry's output per man-hour and profits. The steel companies refused any agreement on price as outside the scope of collective bargaining and contrary to the antitrust laws. They also stated that they "do not intend to enter the bargaining on the basis that there shall be any increase in wages or other benefits."

There is no apparent shortage of manpower, or rise in living costs, warranting advance in steel wages to attract labor. Nor, the strike threat aside, is there apparent justification for steel price advance in terms of either costs or conditions of demand. With public support, the self-defeating wage-price spiral can be effectively challenged.

First Quarter Corporate Earnings

Reports for the first quarter published during April by corporations in all major divisions of business show in most cases a continued recovery in sales and earnings from the depressed levels reached early last year. Figures issued to date by 798 corporations give combined net income after taxes of approximately $3.0 billion. This represents a decrease of 2 per cent from the fourth quarter of 1958 – or less than the usual seasonal pattern of decline – but a re-

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST QUARTER
(In Thousands of Dollars)

No. of Cos.	Industry Groups	Reported Net Income After Taxes First Qr. 1958	Fourth Qr. 1958	First Qr. 1959	Per Cent Change From First Qr. 1958	Fourth Qr. 1958
43	Food products and beverages	$ 80,654	$ 105,140	$ 85,140	+ 6	−19
12	Tobacco products	47,850	63,771	53,089	+11	−17
27	Textiles and apparel	9,203	23,404	22,676	+—†	− 3
8	Tires, rubber products	12,019	27,807	27,429	+—†	− 1
31	Paper and allied products	37,701	53,685	48,139	+28	−10
38	Chemical products	127,142	214,476	207,473	+63	− 3
27	Drugs, soap, cosmetics	82,619	88,555	86,221	+ 4	− 3
37	Petroleum producing and refining	431,417	510,049	534,750	+24	+ 5
49	Cement, glass, and stone	39,765	96,387	75,543	+90	−22
36	Iron and steel	106,460	224,230	264,984	+—†	+18
86	Electrical equipment, radio and television	84,197	142,870	98,870	+17	−31
55	Machinery	57,080	86,791	71,577	+25	−18
95	Other metal products	121,699	189,554	168,331	+38	−11
35	Automobiles and parts	219,798	422,158	513,273	+—†	+22
28	Other transportation equipment	42,976	28,368	35,589	−17	+25
59	Miscellaneous manufacturing	46,471	90,437	69,840	+50	−23
616	Total manufacturing	1,547,051	2,367,682	2,362,924	+53	—†
15	Mining and quarrying	18,154	30,276	22,114	+22	−27
32	Trade (retail and wholesale)	28,721	47,306	34,109	+19	−28
18	Service and amusement industries	14,595	14,909	18,929	+30	+27
50	Railroads	20,057	189,565	85,190	+—†	−55
64	Electric power, gas, etc.	239,157	202,629	261,388	+ 9	+29
3	Telephone and telegraph	214,150	266,827	264,420	+23	− 1
798	Total	$2,081,885	$3,119,194	$3,049,074	+46	− 2

† Increases or decreases of under 1% or over 100% not shown.

bound of 46 per cent from the very poor first quarter of 1958.

Our similar tabulation a year ago showed the 1958 first quarter 31 per cent below the same period a year earlier. Thus, the recovery this year carries the total back to around the same level as the first quarter of 1957. The same dollar net income, however, produces a lower rate of return on the equity capital investment, which has been increased over the two years by retained earnings and new stock issues.

The sharp upturn in earnings will boost materially the flow of corporate income taxes into the U.S. Treasury. This was the area, of course, where revenues fell off most severely during the recession.

The biggest gains this year generally were realized by those manufacturing companies which experienced the worst drops a year ago, and by the railroads. Much more modest gains, mixed with numerous declines, were experienced by manufacturing lines whose operations were maintained a year ago, as well as by electric, gas, and telephone utilities, wholesale and retail trade, and business services. Changes by major industry groups are given in the summary on the preceding page.

Trends in Manufacturing

For 616 manufacturing companies, total net income was approximately the same as in the fourth quarter of 1958, but 53 per cent above the depressed first quarter of 1958. Although more than half of the manufacturers in our tabulation had decreases from the preceding quarter, five out of six made gains over a year ago. The low level of income and the numerous deficits early last year now cause some of the percentage comparisons to soar to almost meaningless heights; three out of every ten reporting manufacturers more than doubled first quarter 1958 results.

Manufacturers' dollar sales billed recovered 16 per cent from a year ago, while the sharper rise in net income improved the average profit margin from 4.9 to 6.7 per cent.

Many companies included with their earnings figures explanatory comments as to temporary or nonrecurring influences that were responsible for record sales or earnings. They warned that first quarter earnings, in some cases more than in the entire year 1958, would give a good start for 1959 but could not be counted on to continue at the same rate of gain for the full year. They forecast that 1959 would be a satisfactory year, yet cautioned their shareholders against taking too rosy a view of the longer-term outlook.

Steel companies, for example, have pushed operations above 90 per cent of capacity to meet the heavy demand for steel products, to restore inventories liquidated in 1958, and to build up extra inventory as protection in the event of a steel strike. Steel demand has set new records as a result of the uptrend in construction and in production of automobiles, machinery, appliances, and many other types of equipment.

Administered Prices

Inflation has many causes, real or alleged. According to Senator Estes Kefauver of Tennessee the villain is "administered prices," which is to say the failure of big manufacturers to jiggle their prices around all the time. And since a majority of administered price adjustments have been in the upward direction the idea seems plausible to some people that monopoly powers are being exercised arbitrarily to raise profits at the expense of consumers.

It is rather odd that "administer," from the Latin verb to serve, should be made into a bad word. Every business, every union is administered. Government administers taxes, postal charges, and civil service salary schedules by fixing rates in law. Government bodies administer utility charges and railroad, bus, and airline fares. Minimum wage laws put floors under the price of labor. "Fair trade" laws require retailers to adhere to stipulated minimum prices, while the Robinson-Patman Act limits manufacturers' price cutting. Farm and stockpiling programs, tariffs, and import quotas have purposes of supporting prices.

So far as government has a broad policy on prices, it is to keep prices up.

The Government Printing Office sells a report on the evils of administered prices at an administered price of 60 cents. Newspapers and magazines print their prices on the front page and make no bones about administering them. Barbers, beauticians, and bootblacks post their prices. The first job a merchant has when goods arrive is to put price tags on them and perhaps to advertise the administered price at which the merchandise will be offered. Auto companies are required by federal law to display suggested retail prices right on their cars.

Among industrial corporations the practice is to have printed price lists which state the prices at which they are prepared to sell. The prices are subject to change without notice, but under normal conditions the schedules do not change frequently. When demand is slack, to be sure, list prices may be "shaded" by various concessions – *e.g.*, freight absorption, elimination of

"extras," and unofficial discounts. When demand is strong, some buyers may offer premiums for quick delivery.

Flexible versus Inflexible Prices

Senator Kefauver, who has been conducting hearings on business pricing off and on for the past two years, is critical of administered prices because they do not change often enough. He contrasts their relative stability, despite changes in demand and supply, with the prices of products traded in open markets where prices are continually fluctuating. He is not concerned with the universality of price administration but concentrates criticism on a few industries – *e.g.*, steel, automobiles, farm machinery.

While most prices are "administered" by sellers, there are continuous auction-type markets for a number of basic commodities such as wheat, cotton, corn, rubber, coffee, cocoa; fluctuating quotations on such exchanges provide a basis for actual transactions between buyers and sellers.

In 1935 Dr. Gardiner C. Means, then economic adviser on finance to Secretary of Agriculture Henry Wallace, elaborated upon the essentially simple facts of the market place. He counted price changes from month to month of 747 items in the Bureau of Labor Statistics (BLS) wholesale price index for the period 1926-33. He found that more than half of the items "averaged less than three changes a year," and concluded: "These items represent a type of price essentially different in its effects from the flexible market price on which the policy of *laissez faire* has been founded."

It assuredly would be news if *laissez faire* (let do or let alone) were to be adopted as U.S. policy toward business.

Last winter, to bring Dr. Means' studies up to date, Senator Paul H. Douglas of Illinois had BLS statisticians tally the number of times 1,789 commodities changed in price between December 1953 and December 1956. The figures were not truly counts of numbers of changes but rather counts of the numbers of times that the price quoted on the 15th of any month was different from a month earlier. Any true count of price fluctuations, of course, would reach astronomical proportions for those commodities traded on some of the exchanges where the products are standardized and there is a multiplicity of sellers.

For the mass of manufactured items, where the product of any one maker is in some respects unique, prices do not change often – perhaps once or twice a year, perhaps once in two or three years, perhaps not at all for many years.

In light of the attack on steel pricing, it is interesting to observe from the BLS study the manifold examples of products whose prices are set in about the same way as steel prices and change about as often.

Picking examples at random, the price of stainless steel slabs changed as often as those for infants' undershirts and bread. Steel rails were as "flexible" as women's rubber heels, electric typewriters, and golf balls. The price on steel bars got changed as frequently as those on men's suits, wristwatches, and baseball gloves. Steel plates chalked up as many price changes as cherry lumber, steel sheets as many as footballs, and steel pipe about as many as jukeboxes.

Dr. Means' Testimony

Dr. Means coined the phrase "administered prices" as a substitute for "inflexible prices"; "flexible prices" he alternatively describes as "market-dominated prices." He has presented his views to the Congress in elaborate detail over the past two years. Out of his testimony and statements three major points stand out: (1) Most prices, including wage rates, are administered; (2) Administered prices are to blame for inflation since 1953; and (3) Such an "administrative" inflation could result from excessive wage increases or from business efforts to increase profit margins.

He distinguishes between two harmful types of inflation – "classical" (too much money chasing too few goods, which he says took place 1942-53) and "administrative" (a rise in prices in "concentrated" industries).

Dr. Means supplied several charts, one of which showed that wholesale prices increased an average of 71 per cent during 1942-53. The inflation of this period, he stated, was "classical" in its source. Analyzing developments from 1953 to October 1958, Dr. Means attributed the 8 per cent average rise in wholesale prices during the period mostly to "administration-dominated" prices–*e.g.*, steel, automobiles, machinery, paper. "Market-dominated" prices, he emphasized, rose little or fell.

There is no necessity to adopt any technical terminology to explain what has been happening in commodity markets since 1953. Prices of basic raw materials – *i.e.*, "market-dominated prices" – normally fluctuate most widely. They were blown sky high during the Korean War and fell back with the restoration of peace and the dissipation of fears of a third world war. In the specific area of farm prices, improvement in productivity (much faster than in manufacturing)

and favorable growing conditions have further operated to reduce prices. Lower prices for imported minerals and agricultural products reflect at least a temporary supersaturation of world demands growing out of the rapid development of newer and cheaper sources of supply.

Administered Wages

Products of American industry, on the other hand, were much more restrained in their rise during the earlier period, a circumstance for which we might be retrospectively grateful. While black markets existed, responsible companies did not charge all the traffic would bear.

Since 1953, labor costs have been pushing inexorably higher, not only in terms of direct wage payments but also in terms of fringe benefits and higher federal employment taxes. Careful and impartial studies show that labor costs were rising during this period substantially faster than gains in national productivity. The only way industry has to finance cost increases, and stay alive, is to raise prices. Policies directed toward bigger government spending and spreading out more purchasing power in the hands of the public have accommodated this creeping inflation.

The twelve major steel companies, desirous of avoiding further increase in steel prices, included the following language in a letter April 15 to USW President McDonald:

> It is economic nonsense to contend, as your union has for many years, that steel worker wage increases can and should be absorbed and paid out of profits. You know, as we do, that wages are the most important element of costs in our industry. If the steel industry had attempted to absorb all cost increases since 1946, without any price increase, by the end of 1957 its losses would have reached a staggering $35,000,000,000. Bankruptcy would have occurred long ago.

Pricing Process: Fact and Fancy

The argument has developed that infrequency of price change is an indication of monopoly (single seller) or oligopoly (a few sellers) control. Thus, we hear that "business giants" can administer prices because they have "no competition" and they have the power to "openly defy" the forces of supply and demand in the market place.

But, as noted earlier, administered prices are not confined to "big business" in "concentrated industries."

Putting the right price on a product is a difficult task. Businessmen must consider a variety of factors – *e.g.*, demand, costs, taxes, prices of competing products, needs for profits. An excessive price risks loss of markets to competitors and competitive products; an inadequate price may result in business failure or lack of financial ability to meet market demands.

If the corner storekeeper pushes up grocery prices too high, the housewife will take her business to the supermarket. Mounting prices for Pittsburgh steel products may mean loss of markets to, say, German producers, or to substitute materials such as reinforced concrete. If copper prices get too high, cable makers switch to aluminum.

It is always popular, when prices are rising, to put the blame upon the seller for "profiteering." Yet the trend has been toward narrowing profit margins over recent years. This would seem to dispose of the argument of "oligopolistic" profiteering. Indeed, if this trend of profits were to continue for long, it could be confidently predicted that the nation will sink into a long slumber of stagnation. Profits are necessary to bring into being the tools and machinery which must be provided for increased employment and economic growth.

In a letter to Senator Kefauver made public April 23, Raymond J. Saulnier, chairman of the President's Council of Economic Advisers, attributed rising prices (of manufactured goods) in most recent years to a tendency for increases in money wages to outstrip improvements in productivity:

> I believe we have tended of late to depart from the historical relation between wage increases and productivity improvements. To the extent that we continue to do so, we will create cost pressures that are bound to erupt in price increases. And if these cost increases cannot be passed on to the consumer in higher prices, they merely create a squeeze on profits that will, over a period of time, seriously impair the nation's capacity for economic growth.

"Fractionalize" Industry?

Congressional hearings over the past two years have turned up a number of suggested "solutions" for the "problem" of administered prices. Two frequently heard are: (1) break up the "big companies" with antitrust or other laws; and (2) inject the Government into the picture with direct price controls or "price review."

Support for the first approach was voiced last fall by Solomon Barkin, director of research for the Textile Workers Union, when he told the Joint Economic Committee that "reasonable and practical fractionalization of these large corporations would be desirable in the public interest." The principal reason we have "business giants" is that there are important economies in large-scale production. Of course if a company runs beyond the size for maximum economy, it will

tend to lose ground to smaller competitors; but arbitrary limits should not be imposed upon efforts to achieve efficiencies of scale.

Even though there are comparatively few U.S. producers, as in the automobile industry, this does not mean there is no competition. Big companies can struggle among themselves, and with foreign competition, harder than if there were a multiplicity of smaller U.S. producers. Indeed, in many lines it would take high tariff barriers, and roughshod antitrust action, to keep alive any large number of producers — and to enforce higher prices against the consumer.

Dr. Means conceded in his testimony before the Senate Subcommittee in July 1957:

> Administered prices represent a way of doing business that leads to greater efficiency and higher standards of living. . . . Without this method of pricing, big efficient industry would find it almost impossible to operate. Administered prices are an essential part of our modern economy.

Even where there is only one producer, as was the case for many years with aluminum, its product has to compete with others. There are many manufacturers of unique products — monopolists in the theoretical sense of the word — who broaden their markets by pricing to gain buyers at the expense of other products. An often ignored facet of competition is in the vastly increased variety of goods offered in the stores. Innumerable new plastics compete in various uses with older raw materials such as steel, copper, paper, glass and rubber.

We need to wake up and recognize that, under liberal trade policies, we live in a world, not in a closed economy. To progress, American industry must be encouraged to grow, rather than prevented from maximizing advantages of scale. Mass production, with its efficiencies and low costs, has brought about economic growth and living standards in this country which are the envy of the world. During World War II our productive capacity was widely acclaimed as a "secret weapon." Faced now with an economic "war" with the Soviets which may well decide the world conflict, it makes little sense to entertain thoughts of tearing apart our productive sinews.

Federal Price Policeman?

The second "solution" — some sort of government price control — is receiving considerable attention these days. Several bills have been introduced in the Congress which call for some government agency to hold public hearings on proposed price and wage increases.

For example, a bill introduced by Senator Joseph C. O'Mahoney of Wyoming would require "dominant corporations" in certain "heavily concentrated" areas to give 30 days advance notice to the Government of intent to raise prices. The Federal Trade Commission and the Attorney General could require the company to justify its price action at a public hearing and to produce all books and records which the Government might regard as necessary. Witnesses for and against the price increase could be called to testify at the discretion of the Government. At the end of 30 days the company would be free to raise its prices.

The bill would supposedly apply to only a few basic industries which are "so heavily concentrated that monopoly or the threat of monopoly is present." Labeling this an "illusion," Roger M. Blough, chairman of U.S. Steel noted in testimony before the Senate Antitrust and Monopoly Subcommittee April 24:

> Actually, however, it would apply to more than half of all the manufacturing industries and subindustries in America, including such "basic" and "heavily concentrated" industries as cured fish, chewing gum, cigar boxes, window shades, greeting cards, phonograph records, wallpaper, street cars, artists' materials, fireworks, candles, garters, corks, sausage casings, unfinished pickles, straw hats, wash cloths and saddlery, harness and whips.

Professor John K. Galbraith of Harvard advocated a public price review board before the Kefauver Committee in 1957 and again this year. However, he intimates that there might have to be some sort of penalties for noncompliance with the board's recommendations. In *The Affluent Society*, Professor Galbraith, a World War II price administrator, favored direct controls "to arrest the wage-price spiral." He thought it "possible that very limited restraints might serve to reconcile capacity output and price stability."

What emerges is the idea that, because prices do not change often enough, they should not be changed at all without government review or permission. Apparently, price cuts might be freely permitted; but who would voluntarily cut a price if an advance could be obstructed when market conditions change? Thus, ironically, the entire line of attack leads to less, rather than more, price flexibility.

All these lines of thinking involve political determination of wages as well as prices in private industry. Let the nose of the "reviewers" under the tent and inevitably the whole "camel" of controls, herded by a burgeoning bureaucracy, would barge in.

There would be no logical stopping point short of controlling substantially all prices and wages (with the inevitable follow-up of ration books), either freezing the economy into a *status*

quo or manipulating it into some idealized pattern. Yet the American people have no wish to turn their freedom of choice over to bureaucrats or to revive the businesses of influence peddling and black marketeering. This is a road to economic strangulation rather than progress.

The Numbers Game

In the space age the universe is expanding. So also are conceptions of what the American economy can accomplish. The progress of other industrial countries, east and west of the Iron Curtain, seems to have stung the national pride.

It has been a favorite armchair exercise this past winter, developing targets for our national production, a sort of numbers game. Challenged by Soviet plans to overtake the U.S. economy in per capita production by 1970, people are saying we must speed our rate of progress beyond the historic 3 per cent a year.

One of the most inveterate setters of ambitious targets is Mr. Leon H. Keyserling, Chairman of the Council of Economic Advisers under President Truman. Writing in the *New York Times Magazine* for November 23, 1958 on the subject, "Next Step – A 600 Billion Dollar Economy?" he stated that the annual growth in our gross national production should be stepped up to 5 per cent a year in order to reach this goal by 1964. Since the Korean War, he asserted, our annual growth has averaged "only a little better than 2 per cent."

The figure which Mr. Keyserling and others use to measure the size of the economy is the money value of the national production of goods and services, commonly abbreviated to GNP. In 1945, the last year of World War II, the GNP was figured at $214 billion. Failing to grow in only four years since then – 1946, 1949, 1954, and 1958 – the GNP is now estimated at $475 billion or thereabouts for 1959. The rate of rise, 1945 to 1959 projected, works out to 5.9 per cent a year compounded. The way we have been going, with essential help from inflation, the GNP might reach a trillion by 1972.

Inflation is a wonderful thing to give delusions of grandeur. It is much easier, by letting the dollar shrink in value, to create the appearance of progress than it is, by applying effort, to achieve the reality.

A Tall Order

Statisticians figure that dollar shrinkage of 2¼ per cent a year accounts for nearly half the growth of the GNP over the past decade. They compute the long-term real growth around 3 per cent. Mr. Keyserling wants the *real* rate pushed up to 5 per cent. In other words, he wants the GNP to rise at a rate of 5 per cent a year *ex* inflation.

Five per cent a year in real terms seems a rather tall order. In the early days of the Republic, when the accent was on rugged individualism and entrepreneurial income was tax-free, the U.S. economy developed with unexampled speed.

But acceleration of real growth is quite another thing in a state which applies its powers to regulate and restrict individual work effort and at the same time to disburse benefits free-of-charge under a hundred programs. To put the matter baldly, pursuance of political philanthropy, however meritorious socially, is not policy for progress. The graver question may be whether, given the inexorably rising tax burden concentrated on work and enterprise, we have a fair chance of sustaining the historic 3 per cent rate.

Another point which may make speeding of growth a difficult matter at the present juncture is made by a distinguished Canadian economist, J. Douglas Gibson of the Bank of Nova Scotia, who recently noted:

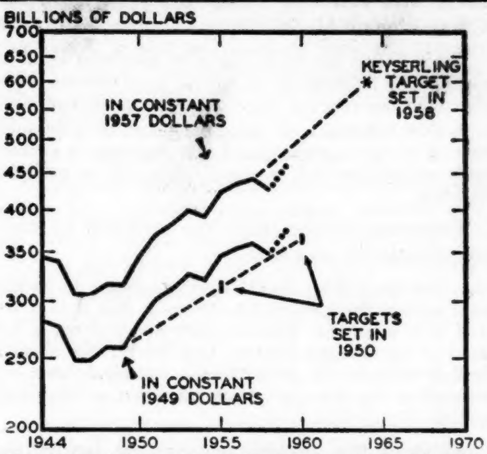
> There is a good deal to suggest, indeed, that the rate of economic expansion may be somewhat less rapid in the next several years than in the past decade. The job of reconstruction has been done; world markets both for industrial materials and manufactures have become much more competitive; and demands are no longer centered on North America as they were when industrial materials and capital equipment were scarce and urgently needed. This may mean that the impetus toward expansion on this continent may be less strong than has been the case for some years.

Old Target Fulfilled

The real GNP is measured in constant dollars by a reconstruction of the past GNP record as it would have appeared if the dollar were always worth what it was worth in some particular year.

The upper curve on the following chart shows Mr. Keyserling's $600 billion target, expressed in 1957 dollars, against the background of the GNP record in 1957 dollars. While he speaks of 5 per cent a year, the projected rate of rise from 1957's $440 billion to $600 billion in 1964 works out to 4.5 per cent per year compounded.

With the passing of the years Mr. Keyserling has raised his targets. Nine years ago when he held responsibility as Chairman of President Truman's Council of Economic Advisers, he had decidedly more modest conceptions of what the U.S. economy could achieve. In the June 18, 1950 *New York Times Magazine* he wrote on "Planning for a $300 Billion Economy." Using the $269 billion annual rate of GNP estimated for



Gross National Product in Constant Dollars (1959 Estimated) with Targets Set by Leon H. Keyserling in 1950 and 1958 (Ratio scale to show proportionate changes.)

the second quarter of 1950 as a jumping off point, he set targets, in heavier old 1949 dollars, of $310-320 billion by 1955 and $360-370 billion by 1960. As the lower curve on the chart shows, Mr. Keyserling's 1955 target was surpassed with around a 10 per cent margin to spare. The 1960 target will be surpassed a year ahead of schedule if present estimates for 1959 are realized.

The Conditions for Economic Progress

Mr. Keyserling had a wiser discernment of the needs for progress in 1950 than has been apparent in his later pronouncements. While asserting that "many public programs are essential even to promote private industrial expansion," he then insisted that "we must strive for, and when international conditions permit should achieve, a budget of diminishing size relative to the size of an expanding economy." He foresaw, within the decade of the 1950's, large reduction of the national debt and very substantial lightening of the tax burden. These hopes have failed of realization.

Now Mr. Keyserling still talks of easing tax burdens and also of a balanced budget. But the argument has a hollow ring. As the taxpayer knows from long experience, endlessly increasing government expenditures require heavier taxes to restrain inflation.

Over the years Mr. Keyserling's attention has become focused on increase of consumer purchasing power, welfare payments, and "National Prosperity Budgeting" as the true means to progress. This emphasis would leave in full force tax blocks to work and enterprise.

Profits are the mainspring of a free enterprise system, and it is cause for sober reflection that corporate profits ran only 10 per cent of the national product generated in the corporate sector during 1953-58 compared to 13.6 per cent in 1947-53. It is for Mr. Keyserling to explain if undue encroachment of wages on profits may not explain slackened growth.

New Douglas Inquiry

The Congressional Joint Economic Committee, under the chairmanship of Senator Paul Douglas of Illinois, is launching a special study to explore "the problems of providing maximum employment and an adequate rate of economic growth, as well as maintaining price stability and preventing inflation." Hearings began March 20.

A preview of some of the theories and points of view that may come out of the special study was provided by the regular annual hearings of the Joint Economic Committee, January 27 – February 10. At the hearings Mr. Walter Reuther, vice president of the AFL-CIO, offered the most glowing predictions of all, suggesting that, "with increasingly accelerated technology," we have it within our power to achieve a GNP of $1½ trillion – $1,527 billion to be exact – by 1982:

> That is where we have to find our new schools. That is where we are going to have to find our medical care and security for our older people and the defense posture that we need and the economic aid program to help the underdeveloped peoples of the world stand up against the Soviet Union's economic penetration and subversion.

Mr. Reuther quoted a statement made five years ago by Henry Ford II that productivity "has grown at an ever quicker pace" but he did not mention what Mr. Ford more recently has called union-made barriers to increased productivity. In a lecture at Yale University February 19, Mr. Ford disclosed that the United Auto Workers had seriously proposed, in the 1958 wage negotiations, that promotion should be based exclusively on seniority, without regard to merit. It is hard to see how economic growth can accelerate when trade union leaders oppose rewards for excellence.

Mr. Reuther demanded government leadership to "mobilize the abundance of our economy." He expressed a low opinion of the traditional means by which the American people got to the top of the heap among the nations:

> . . . You cannot expect the blind forces of the marketplace to meet the complex challenge to our society in the world of automation and atomic power.
>
> We also need to work on the progressive reduction of the workweek. This is not an arbitrary thing. It is a matter that ought to be dictated by the facts of technology, by how much progress we can make in satisfying our material needs and giving people a fuller measure of leisure.

Yet it is in the market place — as well as in the polling place — that free people express what they want. These aspirations are not "blind," however little they may conform to arbitrary patterns that National Prosperity Budgeteers would prescribe. Security and leisure are wonderful things, and planners find it a fascinating pastime to declare dividends out of the ever-growing national production they blithely assume. But all these grand schemes will never get off the ground if they ignore the practical fact that it is incentives and freedoms for hard-working imaginative people that propel progress.

Proposals for More Regulation

Proposals are being put forward in the Congress looking toward more controls on business. At Joint Economic Committee hearings Senator O'Mahoney raised the question time and again whether policies of corporations should not be brought under closer surveillance of federal law with the apparent object of keeping major firms on the one hand from raising their prices and on the other hand from getting bigger. If we want an economy growing *smaller*, this would be a way to do it.

Fuzzy ideas are expressed that we may have to reconstruct — bureaucratize — our economic system to keep up with the Russians. This would be to deny free enterprise opportunity to demonstrate its competitive power. We can never keep up with the Russians with soft socialism; hard socialism goes against the grain of our liberal tradition. If we want to defend freedom we have to look to the motivations of free men and use the carrot to induce rather than the stick to beat people into purposeful work activity responsive to wants in the market.

The United Kingdom is giving a brilliant example of how retreat from socialism, freeing markets and reforming income tax rates, can invigorate the flagging interest of a people in work and progress. With the $1 billion tax reduction announced in April, British taxpayers will have had three cuts in income tax rates since 1953. Meanwhile, the Exchequer revenues, benefiting from the stimulus to economic activity, are projected at $5,325 million in the next fiscal year, 20 per cent above their level in 1952. The lesson is hard to resist: creative tax policies can build the revenues as well as the morale of a people.

Inflation, Growth and Taxes

Senate Majority Leader Lyndon Johnson recently called the issue of inflation "second only to the issue of national survival." A more complacent view was taken by Professor Sumner H. Slichter of Harvard, before the Joint Economic Committee on March 20:

> Labor unions are much the most important cause of modern-day inflation, but a general wage increase is just the right medicine for the economy in its present state.
>
> A slow inflation is an inescapable cost of a desirable rate of economic growth, and it is nonsense to contend such an inflation will eventually turn into a galloping inflation.

Professor Slichter took the occasion to commend inflation as a tax:

> . . . One good thing about creeping inflation to be said over against the problems it causes is that it is a tax, and it is a tax that falls on everyone. It is not a bad kind of tax in many respects. One thing I like about it is that there are no exemptions. . . . Nobody puts any exemptions in there to please this, that or the other group.

Most of the witnesses appearing before the Joint Economic Committee were opposed to inflation and favored restrictive credit and fiscal policies to hold aggregate spending power in check. Federal Reserve Board Chairman Martin said that "first, and perhaps foremost" among potential inflationary factors is the budgetary position of the Federal Government. Speaking of growth, he said:

> Stability is not an end in itself — it is a means to a better standard of living, and I believe we would have had much more growth over the last 10 years and much more permanent growth, if there had been more stability in the economy and there had not been this recurrent instability in both employment and prices. I believe the two work together.

Members of the Joint Economic Committee heard a number of witnesses deplore wastes in federal spending programs. But few were bold enough to predict drastic reforms to improve the efficiency of Government. Suggestions were heard that general increases in federal taxes will become necessary to resist inflationary pressures growing out of recommended enlargements of federal spending. There are the difficulties, however, that general tax increases will tend to raise prices and — levied on incomes — to reduce further the rewards for work and enterprise.

Raymond J. Saulnier, Chairman of President Eisenhower's Council of Economic Advisers, stated that in his judgment the President's proposal for a balanced budget in fiscal 1960 would be a powerful factor aiding economic growth by opening the way to tax reform:

> If that plan is adhered to we can look forward to some reform of our tax structure, and some reduction in our taxes. I would expect this to be a powerful factor making for economic growth.
>
> Furthermore, adherence to this financial plan would have a stimulating effect through our economy at the psychological level.

Other proposals have also been made, but by and large our growth can be promoted by Government at this time through the proper management of our financial affairs.

We are in a good recovery right now, and I expect under appropriate policies that recovery can be carried forward through 1959. And in my judgment, 1960 can be a substantially better year than 1959.

Getting Down to Realities

During the course of the Joint Economic Committee hearings Senator Douglas entered into the record tables which showed that the real GNP in the United States over the past decade has been lagging behind the growth in Europe. Other witnesses spoke of the Soviet growth as double or triple the U.S. rate.

Questioned on the matter, Dr. Saulnier said he didn't pose as an expert on European figures but that he knew "enough about GNP figures to be very skeptical of them." The weaknesses of GNP data become apparent when one considers the impossibility of measuring the "output" of government which is neither priced nor reported in physical units. The point has been made by Neil H. Jacoby, dean of the UCLA Business School and former member of the President's Council of Economic Advisers:

We might hire a million men to dig holes and another million men to fill them up and we are not going to get more growth just because we employ two million men. The question is really: What the employed are doing and how efficiently are they doing it? And this is the essence of the growth problem.

We could get faster growth in real terms if we did not pay so much attention to these monstrous financial magnitudes. We tend to become obsessed with dollars and with the apparent ease of enlarging GNP by more government spending. Later we become shocked and dismayed when we discover that real accomplishment has been so little.

We need to get down to brass tacks and buttress incentives to work and to risk-taking investment. Congressman Wilbur D. Mills, Chairman of the House Ways and Means Committee, has pointed out how the outdated tax system stunts the nation's growth. In financial terms we need to review problems of business finance, and to make sure that taxes, government deficits, and home building do not pre-empt supplies of savings needed for industrial progress.

Needs for "Creative Energies"

Walter D. Fackler, assistant director of economic research for the Chamber of Commerce of the United States, made the major contribution of cold realism to the Joint Economic Committee's hearings. Mr. Fackler asked the question, "Do we want growth dictated and directed by Government, as in Russia, or growth which steps from the creative energies and thrift of a free people?":

Much of the talk of growth and productivity these days is irresponsible, however sincerely intended. . . . comparisons of growth rates of the United States with those of Soviet Russia too often degenerate into an infantile numbers game. . . .

What does it mean, for example, to say that Soviet agricultural output is increasing rapidly, when we are trying to reduce ours?

Many of the prescriptions for improving our performance, he pointed out, "are naive or seem designed to inhibit growth":

Indeed, "growth" has become a popular catchword used to justify any scheme of Government spending, any degree of fiscal and monetary looseness, and many kinds of governmental intervention into private economic affairs.

If we are really serious, as we should be, he went on to say, we should consider the two-fold basic function of Government:

(1) To provide and maintain an economic climate conducive to growth — a climate in which private initiative, innovation and creativity would flourish; and

(2) To provide complementary public services desired by the public which Government can best provide.

In addition to reviewing and eliminating many growth retarding Government activities, probably the biggest step toward creating a sound growth climate would be to overhaul our tax structures. The present Federal tax system is punitive and wasteful. It discriminates against initiative and risk, and it impedes the mobility of venture capital. It helps to destroy State and local fiscal capacities.

But we put off each succeeding year tax reform because of the pressing revenue requirements. We can never start tax reform, unless we start. In addition, we bicker endlessly over the distribution of tax burdens, which are now distributed capriciously and arbitrarily. As a result, any attempt to evaluate our tax system objectively or "rationalize" it meets anguished outcries of those who want special treatment or who make a profession of deluding large masses of people into believing that they can have something for nothing.

Our democracy in action has hardly had a distinguished record on this score. Our political helplessness would be amusing if it were not appalling.

Indeed, if it is growth that we want we will have to reverse recent trends and stop treating the industrious and the venturesome as people to be exploited rather than encouraged. It is, after all, the summation of individual efforts that makes up the national production.

The article "How to Beat Inflation" in the April issue of this *Letter* contained a quotation on art as an investment from the December 6, 1958 *Saturday Review*. The quoted material was attributed to the magazine but the author was not named. He is A. Wilfred May, executive editor of the *Commercial and Financial Chronicle*.